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In the

Supreme Court of the United States

OCTOBER TERM, 1944

No. 703

AMERICAN LIBERTY PIPE LINE CO.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

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Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

To the Honorable The Supreme Court of the United States:

Your petitioner respectfully shows:

SUMMARY STATEMENT OF THE MATTER INVOLVED

This case involves the construction of Section 26(c)(2) of the Internal Revenue Act of 1936. 49 Stat. 1648. Petitioner was chartered as a Delaware corporation December 27, 1935. (R. 39, 67, 72.) Prior to petitioner's incorporation its promoters, on November 15, 1935 (Ex. 1, R. 93, 96) and again on November 21, 1935 (Ex. 2, R. 97-103) offered to sell notes in the sum of $1,250,000.00 to be secured by a first mortgage on the properties of the proposed cor-

poration, to the Republic National Bank & Trust Company of Dallas, Texas. On December 13, 1935 the Republic National Bank & Trust Company agreed to place such note issue, upon compliance with certain conditions precedent set out in the Bank's letter of commitment of that date. (R. 104-110, Ex. 5.) In both the offer to sell made by the promoters and the agreement to purchase made by the Bank, it was stipulated that three-fourths of the net earnings of petitioner should be applied to the payment of principal and interest on such note issue, and one-fourth thereof be set aside in a special fund from which legal organization, financing and other expenses approved by the trustee might be paid, with the provision that any unexpended funds in this account at the end of one year should be applied to the discharge of such indebtedness.

Its charter having been obtained the petitioner proceeded to enter into contracts with Fredell Construction Company to construct 105 miles of pipe line (R. 116-117); Oil Well Supply Company to purchase 36 miles of pipe (Ex. 10, R. 118-119); and National Supply Company to purchase 74 miles of pipe. Each of these contracts was entered into during the month of January, 1936. In each instance also the petitioner, or the promoters acting on behalf of the petitioner assigned a portion of the proceeds of the loan to be obtained from the Republic National Bank & Trust Company either in payment of its obligation under such contracts or as security for such payment.

Republic National Bank & Trust Company was notified by petitioner by letter dated June 11, 1936, that all the terms of the commitment letter requisite to closing the loan

had been performed (Ex. 18, R. 142-144), and on June 18, 1936, the deed of trust was executed by petitioner and the loan was closed, and thereafter the petitioner paid to various creditors the portions of the proceeds of the loan which it had previously assigned to them. (R. 76.)

Subsequent to the date of such deed of trust the petitioner operated under the terms thereof and regularly paid to the trustee the required portion of its earnings until May 1, 1938, when there remained due the sum of $319,-091.12. On that date petitioner obtained a new loan secured by a lien upon all of its properties, from the Bank of The Manhattan Company in the amount of $1,500,-000.00, out of which the balance of the original loan was taken up. The deed of trust securing this note subrogated the Bank of The Manhattan Company to all of the rights, remedies and securities granted to the original note holders. (R. 56.)

Petitioner filed this suit in The Tax Court of the United States alleging that respondent erroneously refused to allow petitioner any credit under the provisions of Section 26(c) of the Revenue Act of 1936 in computing surtaxes on undistributed profits for each of the fiscal years 1937 and 1938. (R. 4, 5.)

The Tax Court held that no contract had been executed prior to May 1, 1936; that even if such contract had been executed prior to that date it had not been executed by petitioner and finally that if a contract were in existence and had been executed by petitioner prior to May 1, 1936,

the claim must be disallowed because no contract executed prior to that time created any "debt." (R. 47, 48.)

On appeal by petitioner the United States Circuit Court of Appeals, by judgment entered July 14, 1944, sustained the holding of The Tax Court and refused petitioner any relief. (R. 176-182.)

The judgment of the Circuit Court of Appeals denies to petitioner any right to relief under the provisions of Section 26(c) from the surtaxes on undistributed profits imposed by the Revenue Act of 1936. This is the only issue presented by this petition.

THIS COURT HAS JURISDICTION

It is contended that this Court has jurisdiction to review the judgment here in question because this is a case "where a circuit court of appeals has rendered a decision in conflict with the decision of another circuit court of appeals on the same matter." [Supreme Court Rule 38, Par. 5(b).]

This Court is expressly given jurisdiction to review by certiorari the decision of the Circuit Court of Appeals "either before or after a judgment or decree by such lower court." (43 Stat. 938, 28 U. S. C. 347.) *Forsyth v. Hammond*, 166 U. S. 506, 17 S. Ct. 665, 41 L. Ed. 1095.

Judgment was entered in this case by the United States Circuit Court of Appeals on July 14, 1944. (R. 176.)

THE QUESTION PRESENTED

The only question presented in this case is whether the petitioner executed a contract in writing prior to May 1, 1936, requiring that petitioner's earnings be paid in discharge of a debt incurred prior to that date within the meaning of Section 26(c)(2) of the Revenue Act of 1936.

REASONS RELIED UPON FOR ALLOWANCE OF THE WRIT

The decision of said Circuit Court of Appeals as to there being no contract and no debt in existence prior to May 1, 1936, is in conflict with the decision of the Circuit Court of Appeals for the Seventh Circuit, on the same matter, in the case of *Commissioner v. Haskelite Mfg. Corp.*, 128 Fed. (2d) 902; with the decision of the Circuit Court of Appeals for the Sixth Circuit, on the same matter, in the case of *Glenn v. Chess & Wymond*, 132 Fed. (2d) 631; and with the decision of the Circuit Court of Appeals for the Fifth Circuit (its own decision) on the same matter in the case of *Scofield v. Valley Pipe Line Co.*, 138 Fed. (2d) 835.

WHEREFORE, your petitioner prays that a writ of certiorari issue under the seal of this Court, directed to the Circuit Court of Appeals for the Fifth Circuit, commanding said court to certify and send to this Court a full and complete transcript of the record and of the proceedings of the said Circuit Court had in the case numbered and entitled on its docket, No. 10,947, *American Liberty Pipe Line Co., Petitioner v. Commissioner of Internal Revenue,*

Respondent, to the end that this cause may be reviewed and determined by this Court as provided for by the statutes of the United States; and that the judgment herein of said Circuit Court be reversed by the court, and for such other relief as to this Court may seem proper.

AMERICAN LIBERTY PIPE LINE CO.,

By GERALD C. MANN,
Counsel for Petitioner.

FOWLER ROBERTS,
Of Counsel.

Dallas, Texas,
November 22, 1944.

In the

Supreme Court of the United States

OCTOBER TERM, 1944

No. .....

AMERICAN LIBERTY PIPE LINE CO.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

OPINIONS OF THE COURTS BELOW

The opinion of The Tax Court of the United States is reported in 2 T. C. 309. It is also printed in full in the record. (R. 31-50.)

The opinion of the Circuit Court of Appeals for the Fifth Circuit is reported at 143 Federal Reporter (2d) 873, and is printed in full in the record at pages 176-182.

JURISDICTION

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code (28 U. S. C. 347). The Circuit Court of Appeals has in this case "rendered a decision in conflict with the decision of another Circuit Court

of Appeals on the same matter." [Supreme Court Rule 38(5)(b)].

Judgment was entered in this case by the Circuit Court of Appeals on July 14, 1944. (R. 176.)

On motion of the petitioner the time for filing this application was extended to November 25, 1944, by order dated October 14, 1944 and signed by Mr. Justice Hugo L. Black.

STATEMENT OF THE CASE

There are no controverted fact issues in the case. In 1935, three individuals who owned several pipe line gathering systems, by virtue of stock ownership in corporations owning such systems conceived the idea of unifying such systems and extending their unified pipe line system some 160 miles to deep water. (R. 64.) In order to accomplish this purpose they proposed to organize a corporation to be known as American Liberty Pipe Line Co., to which would be transferred all of their various pipe line systems and which would construct the additional 160 miles of pipe line. To accomplish such consolidation and extension it was necessary that arrangement be made to borrow a large sum of money. After investigation of the cost of the project and oral discussions with the officers of the Republic National Bank & Trust Company of Dallas, the promoters of the proposed corporation addressed a letter to such Bank on November 5, 1935, setting out the proposed transaction and offering to sell $1,250,000.00 first mortgage 2-year 6% notes, payable quarterly out of three-fourths of the earnings of such proposed corporation, to the Bank. (R. 65; Ex. 1, R. 93-96.)

By letter of November 21, 1935, the promoters again offered to sell such note issue to the Bank. (Ex. 2, R. 97.) This letter set out the proposal in detail, stating the estimated cash requirements for the proposed improvements, and stated further that the promoters proposed to create a first mortgage on the lines to be built by and on those to be conveyed to the new corporation, in the sum of $1,250,000.00 to be evidenced by notes bearing date as of the date of the completion of the new construction and to be due two years after date. It was further stated that the notes were to be further secured by three-fourths of the net earnings of the Pipe Line Company. (R. 99.) It was further stated that in order to make their plans it was necessary to obtain the commitment of the Bank to take the note issue when issued after completion of the pipe line. (R. 102.)

In response to this letter the Bank, on December 13, 1935, agreed to purchase such note issue subject to certain provisions contained in its letter of commitment of that date. (Ex. 5, R. 104.) One provision was that none of the gross income of the corporation should be spent except for actual and necessary operating expenses and taxes, and that the balance remaining should be applied monthly to the discharge of the debt. Another was that the project should be completed, and accepted by the Bank prior to June 30, 1936. (R. 109, 110.)

All the interested parties, including the Bank knew, at all times, that the commitment of the Bank was essential to the financing of the proposed project. (R. 72 and 73.) Not until June 18, 1936, was the project completed and

the notes issued and purchased in pursuance of the contract entered into between the Bank and the promoters. (R. 73.) Petitioner was incorporated under the laws of Delaware on December 27, 1935, and obtained a permit to do business in Texas on January 16, 1935. (R. 66, 67.) All of the negotiations, however, entered into by the promoters prior to the date of its incorporation were conducted for the benefit of petitioner. (R. 71.)

Credit was obtained from the contractors and suppliers, by the petitioner on the basis of the commitment of the Bank in its letter of December 13, 1935. (R. 72.) The American Liberty Oil Company expended $200,000.00 for petitioner on the basis of that commitment. (R. 72, 73.) Petitioner agreed to assign and Fredell Construction Company agreed to accept a portion of such commitment in payment for its construction work. (Ex. 9, R. 115-118.) Acting for petitioner the promoters assigned out of this commitment: to the National Supply Company an amount sufficient to liquidate their supply and construction account (R. 122), which ultimately amounted to $532,039.02 (R. 145); $42,000.00 to Liberty Pipe Line Company (R. 125); to Oil Well Supply Company the sum of $152,000.00. (R. 118, 119.) Each such assignment was irrevocable, and was made after the organization of petitioner, by the petitioner in one case, and by its officers acting for it in each other instance. The petitioner having performed its agreement fully, notified the Bank of such performance and on June 18, 1936, the deed of trust was executed and the money paid over to the petitioner in accordance with the terms of the letter of commitment. Immediately thereafter petition-

er paid out practically all of the $1,250,000.00 proceeds of the loan to its assignees, in accordance with its agreements. (R. 73.) Thereafter payments out of the earnings of petitioner were made to the Bank monthly, in strict compliance with the terms of the original contract represented by the Bank's letter of commitment and the deed of trust. (R. 83.)

Your petitioner takes the position that when the Bank accepted the offer of its promoters to sell mortgage notes to be issued by petitioner, a written contract was executed and that when it assigned portions of the proceeds of the loan to become available under the terms of the Bank's letter of commitment it thereby adopted and became a party to and executed a contract in writing, and bound itself to pay a debt which it then incurred, out of its earnings—a contract which required such payment during the taxable years here involved, and which was executed by petitioner prior to May 1, 1936, within the plain terms of Section 26(c)(2) of the Revenue Act of 1936.

ERRORS RELIED UPON

1. The Circuit Court of Appeals erred in holding that the contract upon which petitioner made payments was neither in existence nor executed by petitioner until after May 1, 1936.

2. The Circuit Court of Appeals erred in holding that execution of the deed of trust of June 18, 1936 constituted a new contract and that the debt on which the payments were made was not in existence prior to May 1, 1936.

ARGUMENT

POINT I

The contract relied on was in existence and was executed by petitioner prior to May 1, 1936, within the meaning of Section 26(c)(2) of the Revenue Act of 1936.

Section 26(c)(2) of the Revenue Act of 1936 reads as follows:

> "SEC. 26. CREDITS OF CORPORATIONS.
>
> "In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing the tax * * *.
>
> "(c) CONTRACTS RESTRICTING PAYMENT OF DIVIDENDS.
>
> * * * * *
>
> "(2) DISPOSITION OF PROFITS OF TAXABLE YEAR.
>
> "An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by a corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. For the purposes of this paragraph a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word 'debt' does not include a debt incurred after April 30, 1936."

The Circuit Court of Appeals, in speaking of the decision of The Tax Court, says:

> "We think it too clear for argument that the court was right in its conclusion that the contract under which the actual payments were made was neither in existence nor executed by petitioner until after May 1, and because it was not the claim fails."

In thus denying the existence of a contract the court is directly in conflict with the Circuit Court of Appeals for the Sixth District in the case of *Glenn v. Chess & Wymond*, 132 Fed. (2d) 621. The facts in that case are fully set out in the opinion of the District Court reported at 40 Fed. Supp. 666. In that case the plaintiff claimed credit upon undistributed profits, predicated upon a contract restricting payment of dividends in accordance with the provisions of Section 26(c)(1) of the Revenue Act of 1936. The bank offered to extend credit on certain conditions. The president of the taxpayer corporation (who simply signed his name individually, and without identifying his official relationship to the corporation) wrote a letter thanking the bank for its coöperation. The conditions in the bank's offer were fulfilled and the credit extended. One of the statements in the letter, and the only restriction on the payment of dividends in the entire contract was a statement in the bank's letter offering credit that the bank "would definitely oppose the payment of such dividends, however, should the earnings fall under $30,000.00 per quarter."

The court held that the letter of appreciation written by the president of the corporate taxpayer, constituted an acceptance of the bank's offer and that the two letters to-

gether constituted a binding contract that the taxpayer would not pay dividends except in accordance with such letter of the bank saying:

> "* * * While the phrasing of the offer could have been clearer, it must be understood and construed as an express provision that the credit was offered on condition that no dividends would be paid unless the earnings exceeded the given amount."

A much stronger case is here presented than that in the *Chess & Wymond case*. Here, it is true, the contract was in the first instance entered into between the promoters and the bank, prior to the incorporation of petitioner. That was merely the first step in the execution of this contract by the petitioner. One of the conditions of the contract was that petitioner should be incorporated. It is abundantly clear that the entire contract was made by the promoters for the benefit of the petitioner, and that the bank recognized this fact. The petitioner was incorporated and immediately proceeded to carry out the terms of the contract with the bank by entering into various contracts of construction, supply and purchase.

It had no assets other than the agreement of the bank to finance its construction and purchases. It was therefore necessary to adopt and the petitioner did adopt the contract of its promoters, substituting itself for them as the obligor to the bank, and assigning various portions of the bank's commitment to them in return for their supplies and work. From the moment that it adopted such contract by assigning portions of it in writing, that contract became the contract of this petitioner, and was executed by it under

the holding of the court in the case of *Glenn v. Chess & Wymond*, 132 Fed. (2d) 621, and within the meaning of Section 26(c)(2), Revenue Act of 1936.

The contract was therefore in existence prior to May 1, 1936.

POINT II

The debt upon which petitioner made payments was in existence prior to May 1, 1936.

The Circuit Court of Appeals held that the debt upon which the payments were made was not in existence prior to May 1, 1936, and stated:

> "* * * We think it quite plain too that The Tax Court was right in holding that whatever might have been said of Taxpayer's case, had its obligations for supplies and construction been simply renewed or extended, this did not occur here. On the contrary, there was a complete discharge of those debts with the making of a new contract with a new creditor, and our decision in Houston Cotton Exchange Bldg. Co. v. Comm., 134 F. (2d) 323, is controlling."

In making this decision the court has rendered a decision in conflict with the decision of the Circut Court of Appeals for the Seventh Circuit on the same matter in the case of *Commissioner of Internal Revenue v. Haskelite Mfg. Corporation*, 128 Fed. (2d) 902, and insofar as the court refuses to allow credit for the indebtedness incurred to the supply companies and the contractors and other persons who actually furnished funds to petitioner prior to May 1, 1936, its decision is in conflict with the decision of the said Circuit Court of Appeals for the Fifth Circuit in

the case of *Scofield v. Valley Pipe Line Co.*, 138 Fed. (2d) 835.

In *Commissioner v. Haskelite Mfg. Corporation*, 128 Fed. (2d) 902, the taxpayer, in 1933, attempted to borrow money from the RFC. At that time the RFC made loans only through a subsidiary. The taxpayer made application to the subsidiary, which then applied to the RFC which granted the loan in 1934. The collateral furnished by the taxpayer was delivered to the RFC. Taxpayer received $180,000.00 in cash of the loan and the remaining $20,000.00 thereof was used to purchase stock in the subsidiary. A clause in the loan agreement forbade the declaration of dividends. The taxpayer defaulted and the default continued until 1937. In 1936 it applied to RFC for a new loan in the amount of $300,000.00, $200,000.00 of which was to be applied to payment of the indebtedness to the subsidiary. The application was at first denied, but in November, 1936, a loan of $200,000.00 was authorized by RFC. The transaction was completed in 1937. The indebtedness to the subsidiary was discharged at the time the loan was closed. Both the taxpayer's application and the resolution of RFC authorizing the loan, contained provisions prohibiting the payment of dividends until the discharge of the obligation.

In overruling the contention of the Commissioner that the required contract had not been executed prior to May 1, 1936, the court said:

> "The fallacy of the position, however, lies in the fact that petitioner (the Commissioner) treats the transaction between respondent and the RFC in 1936-

> 1937 as a new contract unrelated to the situation previously existing between the same parties * * *. As a matter of fact, there can be little, if any, question but that the transaction between respondent and the RFC in 1936-1937, was in reality, merely a continuation of the loan made in 1934. At all times material to the instant situation, respondent was restricted from the payment of dividends because of a written contract executed prior to May 1, 1936. The fact that a later agreement in identical language reiterated the same restriction does not justify the conclusion that it was a different restriction or that the rights of the parties were altered thereby. The RFC was the actual creditor in both transactions. The principal of both notes was the same. The mortgages and assignments executed in 1937, covered the same property as those executed in 1934."

So, in this case, the fallacy of the position stated by the Circuit Court of Appeals lies in the fact that the court treats the letter of commitment of the bank, the assignment of portions thereof by the petitioner to its materialmen, vendors and contractors, all prior to May 1, 1936, and the execution of the notes to the bank on June 18, 1936, as wholly unrelated transactions. It is entirely clear from this record, however, that all of these steps were part of one and the same transaction. It was known at all times and to all parties involved that the bank had committed itself to loan the necessary money to petitioner to finance the proposed operations of petitioner. The conditions of the commitment were also known, and it was likewise known that petitioner had no assets with which to finance its operations other than the bank's commitment. With the knowledge and consent of the bank, the materialmen, contractors and vendors extended credit to the petitioner in

reliance, not on petitioner, but upon the commitment of the bank. The bank, at all times, was the real creditor. At all times during the period after the assignment of portions of the bank's commitment to the end of the years in controversy here, the petitioner was bound to pay this obligation out of its earnings.

At no time after such assignment could it refuse to take any necessary steps to carry out its obligations under its contract with the bank. It had to purchase properties; it was compelled to build pipe lines; it was forced to purchase supplies and it was essential that it execute the notes to the bank, as successive steps in carrying out its written contract with the bank. It could not refuse to take any one of these successive steps. It was under the compulsion of the contracts of assignment which it had executed to third parties. These contracts, however, were anticipated by both the bank and petitioner; the credit obtained as a result thereof was credit in fact extended by the bank to the petitioner, a part of the indebtedness to the bank which was secured by the earnings of petitioner. The making of the notes was merely the final step, the last formality in the series of steps necessary to make complete the contract entered into by the bank and the promoters in December, 1935 and thereafter adopted by petitioner in January, 1936.

The principle of *Commissioner v. Haskelite Mfg. Corp.*, 128 Fed. (2d) 902 is controlling here, and the decision of the Circuit Court of Appeals in this case in holding that no debt existed prior to May 1, 1936 is in conflict with it.

Moreover, in holding that the contract executed in June, 1936 by the petitioner is a new contract, and is not merely in continuation of the original contracts with the bank and the third parties involved, the decision of the Circuit Court of Appeals is in conflict with its earlier decision of *Scofield v. Valley Pipe Line Co.* (5th, C. C. A.), 138 Fed. (2d) 835. In that case the court was dealing with an agreement under which the earnings were to be applied to debts created after as well as to those created prior to May 1, 1936. It made this statement:

> "The fact that the provision of the contract obligates the earnings and profits to the payment of future, as well as past, indebtedness, does not in any wise prevent its being a complete compliance with the statute. The statute does not require that *all of the earnings and profits* of the taxable year be by the contract devoted to the payment of the debt it refers to. It requires that some of them be, and it gives credit to the extent that they are so applied. There was compliance with it here."

In the instant case the petitioner was obligated to pay practically the entire amount of the loan to third parties who had extended credit in anticipation that the indebtedness owed to them would be refunded and refinanced through the bank, credit that had been extended in reliance upon the bank's promise to make the funds available upon completion of their work.

The obtaining of credit from these parties was one of the steps necessary to the completion of the agreement made by petitioner with the bank. The refinancing of such obligations so made was one of the duties of the bank under its contract. When the notes were executed and the money

paid over to petitioner no new contract was made and no new debt was created. This was simply the final step in the performance of the contract already in existence between the bank and the petitioner. The same debts existed; the same real creditor, the bank, held the contract with petitioner which required petitioner to pay its earnings monthly in discharge of a debt created when it obligated itself to pay its materialmen, contractors and vendors.

The same situation exists here that existed in *Scofield v. Valley Pipe Line Co.*, 138 Fed. (2d) 835, and the decision of the court in this case is in conflict with its decision on the same matter in the *Scofield case*.

CONCLUSION

Had Section 26(c)(2) of the Revenue Act of 1936 been in existence at the time of the negotiations with the bank or had it been in existence at any time prior to the date of the last step taken in the performance of the petitioner's contract with the bank (June 18, 1936) it would have been an easy matter for the petitioner to have complied with the statute with all the nicety now required by the Circuit Court of Appeals. But the act was not passed until four days after the completion of the last step in the performance of the contract. (June 22, 1936.)

Even so, the intention of the parties is apparent, and that intention must govern. It is also apparent from this record that at no time from the execution of the contract

of December 13, 1936 through the years here involved, could the petitioner do otherwise than apply its earnings to the discharge of the debt then anticipated, and actually created prior to May 1, 1936.

The history of the act makes it plain that the intent of Congress was to prevent the accumulation of large undistributed profits by corporations, and to add to the public revenue by taxing the distributed profits in the hands of the stockholders. This object was accomplished by a graduated tax upon undistributed profits and earnings. It was never the intent of the act to penalize a corporation for non-distribution of profits when there was a legitimate need for them in the business. To assure that the need was legitimate, however, the Congress provided certain tests for legitimacy, that is, the need must be evidenced by a written contract executed by the corporation prior to May 1, 1936, and such contract must require the payment of its earnings in the discharge of a debt during the taxable year or that they be irrevocably set aside within the taxable year for the discharge of a debt.

To deny the execution of a written contract by the petitioner prior to May 1, 1936, in this instance and to deny the existence of the debt—to deny that such written contract requires the earnings and profits of the taxable years, here involved, to be applied to the payment of that debt is to ignore the realities of the case and to decide it upon a state of facts which does not exist.

It is therefore respectfully submitted that this case is one calling for the exercise of this Court of its supervisory powers, by granting a writ of certiorari and thereafter reviewing and reversing said decision.

Respectfully submitted,

GERALD C. MANN,
Counsel for Petitioner.

FOWLER ROBERTS,
Of Counsel.

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 703

AMERICAN LIBERTY PIPE LINE COMPANY,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court of the United States (R. 33–50) are reported in 2 T. C. 309. The opinion of the Circuit Court of Appeals (R. 175–181) is reported in 143 F. 2d 873.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 14, 1944 (R. 181). The petition for a writ of certiorari was filed on November 25, 1944, pursuant to an order granting an exten-

sion of time (R. 182). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, within the intendment of Section 26 (c) (2) of the Revenue Act of 1936, the taxpayer corporation was required by a provision of a written contract executed by the corporation prior to May 1, 1936, to apply its earnings of the taxable year in discharge of a debt incurred prior to the same date.

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

(c) *Contracts Restricting Payment of Dividends.*—

* * * * *

(2) *Disposition of profits of taxable year.*—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be

paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. For the purposes of this paragraph, a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word "debt" does not include a debt incurred after April 30, 1936.

STATEMENT

Taxpayer was incorporated in Delaware on December 27, 1935 (R. 39), for the purpose of unifying and extending pipe-line systems which were already owned or controlled by its three promoters. Prior to incorporation, the promoters initiated negotiations with the Republic National Bank and Trust Company of Dallas, Texas, to secure necessary financial assistance for the project. (R. 34–35.) In a letter to the promoters on December 13, 1935, the bank agreed to loan taxpayer, when organized, $1,250,000, secured by first mortgage 6% two-year notes, payable quarterly out of three quarters of taxpayer's net earnings, this loan to be made "as and when the following stipulations and conditions have been fully met and complied with" (R. 37). The conditions mentioned included full completion of the con-

templated pipe-line construction on or before June 30, 1936, the bank expressly disclaiming any obligation unless this condition was fulfilled. Two of the promoters entered the notation "accepted" on the last page of this letter. (R. 37–38.) Thereafter, taxpayer was incorporated, with the promoters as directors and officers (R. 39). Contracts were then entered into with three companies for the pipe-line construction. The promoters secured each of these contracts with assignments of portions of the bank's conditional agreement of December 13, 1935. (R. 39–40.)

On May 30, 1936, the consulting engineer employed by the bank reported completion of the pipe line,[1] and on June 11, 1936, taxpayer advised the bank that the conditions mentioned in the conditional agreement had been performed (R. 41–42). Taxpayer executed a deed of trust and chattel mortgage to the bank, as trustee, on June 18, 1936, to secure payment of notes aggregating $1,250,000 funded by the bank. The proceeds of this loan were immediately made available to taxpayer, and checks were issued to the contractors in accordance with the assignments. (R. 42.) Pursuant to the terms of the deed of trust, periodic payments from taxpayer's earnings were made to the bank to apply on the principal and interest due on the notes (R. 42–43). In 1938 taxpayer

[1] The engineer had previously reported that the project was approximately 95% completed on May 2, 1936 (R. 41).

refinanced its business through a new loan from the Bank of Manhattan Company. This loan was also secured by a deed of trust on taxpayer's properties, and it was stated that the indebtedness was in renewal and extension of the balance still outstanding under the June 18, 1936, loan. (R. 43.)

In its tax returns for the fiscal years ending 1937 and 1938, taxpayer claimed a credit under Section 26 (c) (2) of the Revenue Act of 1936 (*supra*, pp. 2–3) for payments made under both the loan of June 18, 1936, and the subsequent loan. The Commissioner disallowed this credit and determined a deficiency. (R. 19.) The Tax Court upheld the Commissioner's determination (R. 50) and this decision was affirmed by the Circuit Court of Appeals (R. 181).

ARGUMENT

The credit allowed by Section 26 (c) (2) of the Revenue Act of 1936 (*supra*, pp. 2–3) is expressly conditioned upon the existence of a written contract executed by the taxpayer prior to May 1, 1936, relating to the discharge of a debt incurred prior to the same date. Since this credit is in the nature of a special deduction, the taxpayer is required to demonstrate strict compliance with all of these conditions. *Helvering* v. *Ohio Leather Co.*, 317 U. S. 102, 106; *Helvering* v. *Northwest Steel Mills*, 311 U. S. 46, 49. In hold-

ing that the taxpayer failed to sustain this burden, the courts below correctly decided a question which does not call for further review.

The only writing in existence prior to May 1, 1936, dealing with the disposition of taxpayer's earnings is the bank's conditional agreement of December 13, 1935.[2] The holding of the Circuit Court of Appeals that this letter did not constitute a contract within the purview of the statute is squarely in accord with decisions of other circuits. *Rahr Malting Co.* v. *United States* (C. C. A. 7th), decided November 16, 1944 (1944 P-H, par. 62, 767); *Florence Cotton Mills* v. *Commissioner*, 126 F. 2d 1017 (C. C. A. 5th); *Bethlehem Silk Co.* v. *Commissioner*, 124 F. 2d 649 (C. C. A. 3d); *Morgan Mfg. Co.* v. *Commissioner*, 124 F. 2d 602 (C. C. A. 4th). Under these decisions, the letter was at most a unilateral offer which did not ripen into a binding contract until its conditions were fulfilled. Taxpayer has failed to make any showing that these conditions were met before May 1, 1936. In fact it affirmatively appears that the condition relating to the pipe-line completion was not complied with until after this date (R. 41). And clearly there was no contract relating to a disposition of taxpayer's earnings enforceable by the bank until the loan was actually made on June 18, 1936. *Rahr Malting Co.* v. *United*

[2] The first deed of trust was not executed until June 18, 1936 (R. 42).

States, supra; cf. *Central West Coal Co.* v. *Commissioner,* 132 F. 2d 190 (C. C. A. 7th).[3]

Moreover, the conditional agreement was executed by the promoters and not by taxpayer. Taxpayer's contention that it adopted this agreement by virtue of the assignments relating to the pipe-line construction contracts (Pet. 14) rests, as the Tax Court concluded, on "farfetched inference" (R. 47). For example, none of these assignments was executed by taxpayer (R. 113–123), and the promoters did not use the conditional agreement to secure credit for taxpayer exclusively (R. 122–129). The fact that the agreement may have been undertaken with the intention that taxpayer would carry it out is without significance. Cf. *Phebus Oil Co.* v. *Commissioner,* 134 F. 2d 217 (C. C. A. 5th). More than a tenuous adoption of this nature is required to sustain the burden of proving that the contract was "executed by the corporation" within the precise meaning of that phrase. Cf. *Mastin Realty & Min. Co.* v. *Commissioner,* 130 F. 2d 1003, 1006 (C. C. A. 8th).

A third fatal deviation from the conditions prescribed by Section 26 (c) (2) is the absence of a debt incurred by taxpayer prior to May 1, 1936,

[3] *Glenn* v. *Chess & Wymond,* 132 F. 2d 621 (C. C. A. 6th), relied upon by the taxpayer (Pet. 13) as presenting a conflict, involved no question of timely execution of a contract, for conditions specified in a letter authorizing a loan were fulfilled and credit was extended prior to May 1, 1936.

dischargeable out of its earnings. Even assuming the existence of a binding contract executed by taxpayer with the bank prior to the critical date of the statute, taxpayer clearly did not become indebted to the bank until the loan was actually made on June 18, 1936. As held by the courts below, there is no basis for taxpayer's assertion (Pet. 15–20) that this loan was merely a continuation of indebtedness incurred prior to May 1, 1936, on the various construction contracts. These debts, which did not relate to a disposition of taxpayer's earnings, were fully discharged and a different obligation, new as to terms and creditor, was incurred on June 18th (R. 42). Unquestionably, this did not constitute a renewal or refinancing of indebtedness. *Houston Cotton Exchange Bldg. Co.* v. *Commissioner,* 134 F. 2d 323 (C. C. A. 5th).[4]

This case raises no question of importance in the administration of the tax laws, and there is no conflict of decisions. In view of the fact that the provisions of the statute here involved were not continued in the Revenue Act of 1938, cases involving Section 26 (c) (2) can arise only with respect to income earned during 1936 and 1937.

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[4] The cases relied upon (Pet. 15–20) by taxpayer in this connection are not in conflict. *Commissioner* v. *Haskelite Mfg. Corp.*, 128 F. 2d 902 (C. C. A. 7th), involved the same creditor throughout, with the same conditions imposed by the loans involved, while *Scofield* v. *Valley Pipe Line Co.*, 138 F. 2d 835, decided by the Fifth Circuit., did not even concern a question of continuing or refinancing an existing debt.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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